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REVIEW OF WHOLESALE ELECTRIC MARKET DESIGN	§ § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

OFFICE OF PUBLIC UTILITY COUNSEL'S COMMENTS ON PHASE II MARKET DESIGN CONCEPTS AND PRINCIPLES

The Office of Public Utility Counsel ("OPUC") respectfully submits these comments in response to Public Utility Commission of Texas Staff's ("Commission Staff") December 6, 2021 request for comments on Phase II Market Design Concepts and Principles.[1] The proposed Phase II market design elements consist of two parts: a load-side reliability mechanism and a backstop reliability service.[2]

The load-side reliability mechanism includes two options:

1. A Load-Serving Entity ("LSE") Obligation as described in Chairman Lake's October 20, 2021 memorandum.[3]
2. A Dispatchable Energy Credits ("DEC") program as described in Commissioner McAdam's November 17th, 2021 memorandum.[4]

The backstop reliability service will be designed to procure accredited new and existing dispatchable resources to serve as an insurance policy to help prevent emergency conditions in the Electric Reliability Council of Texas ("ERCOT"). A description of how such a service may be implemented is reflected in Commissioner Cobos' November 18, 2021 memorandum.[5]

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[1] Memo - Regarding Written Comment for Phase II Market Design at 1 (Dec. 6, 2021) ("Request Memo").

[2] Request Memo.

[3] Chairman Lake Memo regarding ERCOT market redesign (Oct. 20, 2021) ("Chairman Lake Memo").

[4] Commissioner McAdams Memo (Nov. 17, 2021).

[5] Commissioner Cobos' Memo (Nov. 18, 2021).

I. BACKGROUND

Senate Bill 3 ("SB3") established an overall objective to ensure reliable operation of the ERCOT grid, especially during extreme weather conditions and during times of low non-dispatchable power production.[6] Thus, OPUC believes that the appropriate market design is one that best meets the objectives and goals of SB3.

From OPUC's perspective, residential and small commercial consumers who will ultimately pay for the Phase II programs expect measurable improvements in grid reliability. An effective program is one that provides clear direction to generation providers on the amount and type of generation needed in order to ensure the necessary grid reliability. After reviewing the proposals outlined in Commission Staff's request for Phase II comments, it is OPUC's conclusion that the following ranking of proposals best meets the objectives of SB3 and provides measurable improvements in grid reliability: (1) Backstop Reliability Service, (2) DEC Program, and (3) LSE Obligation.

II. BACKSTOP RELIABILITY PROGRAM

The program that can most clearly meet the reliability objective is the backstop reliability service. The proposal to allow ERCOT to procure a reliability service through a competitive request for proposal ("RFP") process will ensure the "right" resource is procured at the "right" price.[7] Using an RFP process allows ERCOT to specify the amount and type of resource necessary through the published request, while a competitive bidding process ensures that the cost to consumers is market-based by allowing for selection of the most cost-effective proposal, exactly as a market is designed to do. A carefully crafted RFP would allow new and existing generation, new technologies, and demand reduction programs to compete for the reliability service, giving the State a diverse safety net of Megawatts. Importantly, ERCOT has experience with the RFP process and could readily implement such a program in short order.

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[6] Tex. S.B. 3, 87th Leg., R.S. (2021). *See* Public Utility Regulatory Act ("PURA") § 39.159.

[7] Commissioner Cobos Memo.

III. DEC PROGRAM

Under the DEC program, an LSE will need to hold DECs equal to its share of system peak demand. Such a program provides value because it is a flexible "currency" that can be bought, sold, or traded. The value of this proposal to consumers is in the flexibility it brings. Requiring an LSE to hold DECs equal to its system peak demand is beneficial, because the required amount of DECs required grows with the LSE's growth in load. If LSEs are required to have enough credit for their system peak demand, the LSE should be more reliable and prepared for that demand. In other words, the DEC program has the potential to be a leading response, anticipating and preparing for growth, rather than a reactionary program that only adjusts after the occurrence of the growth. The value of a credit is reflective of market conditions. When there is sufficient generating capacity, the price of credits will be low, when capacity is tight, the price of credits will be high. This program can be modeled after the existing renewable energy credits ("REC") program, meaning the time to implementation can be short.

Although a helpful proposal, the drawback to the DEC program is that it is unclear that establishment of a DEC program would guarantee that new dispatchable generation will be installed as a result. For example, significant renewable generation has been built in Texas. While the REC program may have been a contributing factor, Federal investment tax credits ("ITCs") have been a major driver for that growth in renewable generation, meaning that the effectiveness of the REC program is difficult to determine. There is no equivalent ITC incentive for new dispatchable generation in the ERCOT market, so it cannot be determined with reasonable certainty that new generation will be built as a result of the DEC program. The requirement that DECs be held by LSEs will certainly increase the cost to end users served by LSEs, but it does not guarantee more dispatchable generation will be built as a result.

OPUC is intrigued by the potential of this proposal but is concerned with its uncertain results and certain cost implications to residential and small commercial consumers. OPUC recommends that the Commission continue to consider this proposal in the long term for further study but urges caution with its adoption in the immediate term.

IV. LSE OBLIGATION

This proposal is a more ambitious program that OPUC believes will increase costs to consumers without guaranteeing a corresponding benefit. OPUC described its concerns with the LSE Obligation in its November 1, 2021 comments to the Commission.[8] In its comments, OPUC explained that the LSE has no ability to impact the actual operation, availability or dispatchability of generation assets in ERCOT.[9] The Commission has repeatedly stated its desire for new steel in the ground, representing the need for new generation. Unfortunately, an LSE Obligation offers little guarantee to improve physical operational reliability in the real time market. It will, however, offer the potential to extract even more dollars out of existing generation, at the expense of consumers, without ensuring future investment in additional generation facilities.

Furthermore, OPUC believes customer choice will be adversely impacted by the proposed LSE Obligation, as it requires LSEs to firm up a load obligation for a period that could exceed the normal consumer's average sales contract. Consumers who can presently shop for an electric provider and can switch providers rather seamlessly may be prevented from doing so because of its provider' s long term capacity obligation. This offers the opportunity for providers to offer higher prices for shorter contracts, or imposing fees for consumers to get out of their contracts earlier. This will cause a domino effect that would shift the extra costs disproportionately to residential and small commercial consumers.

In addition to the scenario previously laid out, smaller non-affiliated Retail Electric Providers ("REPs") generally offer lower rates for their products which puts downward pressure on overall prices in the market. If there is an LSE Obligation, it is possible that at least some of these REPs will be acquired by REPs with affiliated generation or will go out of business altogether. This will have the effect of raising prices through market consolidation, and hence, overall costs to customers. In addition, an LSE Obligation opens the door to creating a high degree of concentration of generation asset ownership and REP loads served among affiliate companies in ERCOT.

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[8] OPUC's Response to Commission Staff's Request for Written Comments to Specific Questions on Review of Wholesale Electric Market Design (Nov. 1, 2021) ("OPUC Market Design Initial Comments").

[9] OPUC Market Design Initial Comments at 6.

V. HYBRID MODEL

Staff's request for comments suggested that a hybrid approach incorporating various combinations of the market design models may be considered.[10] OPUC fully supports this idea. Unquestionably there is no single solution to improved grid reliability, thus a hybrid approach would best meet the objectives of SB3. Specifically, OPUC supports the development of a backstop reliability service along with a market-driven DEC program. The benefit of such a combination is that the RFP component of the reliability service provides the platform to explicitly identify and secure the type of resource needed at a cost that is set by competitive bid, while the DEC program provides the trade flexibility and pricing signals that the market requires to invest in new generation. Both models are based on programs already established in Texas, so can be implemented at a relatively lower cost and in a relatively shorter time.

VI. CONCLUSION

OPUC appreciates the opportunity to provide these comments on the Phase II Market Design Proposals and looks forward to working with Commission Staff and other stakeholders in this project.

[10] Request Memo.

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OPUC's EXECUTIVE SUMMARY COMMENTS ON PHASE II MARKET DESIGN CONCEPTS AND PRINCIPLES

OPUC's comments make the following points and observations:

- SB3 established an overall objective to ensure reliable operation of the ERCOT grid, thus, the appropriate market design is one that best meets the objectives of SB3.

- From OPUC's perspective, residential and small commercial customers, who will ultimately pay for the Phase II programs, expect measurable improvements in grid reliability as a result of these programs.

- The program that can most clearly meet the reliability objective is the backstop reliability service. This program allows ERCOT to procure a reliability service through a competitive request for proposal ("RFP") process and will ensure the "right" resource is procured at the "right" price.

- A DEC program provides value because it is a flexible "currency" that can be bought, sold, or traded. The value of a credit is reflective of the market – when there is sufficient generating capacity the price of credits will be low; when capacity is tight, the price of credits will be high. However, while the requirement that DECs be held by LSEs will certainly increase the cost to end users served by LSEs, it does not follow that more dispatchable generation will be built as a result, leaving consumers without the guarantee of a benefit for the cost.

- The LSE Obligation is a more ambitious program that OPUC believes will increase costs to consumers without guaranteeing a corresponding benefit. The LSE has no ability to impact the actual operation, availability or dispatchability of generation assets in ERCOT. Thus, an LSE Obligation offers less of a guarantee to improve physical operational reliability in the real time market but does offer the potential to extract even more dollars out of consumers for existing generation without ensuring any future investment in additional generation facilities.

- A hybrid development of a backstop reliability service along with a market-driven DEC program would best meet the objectives of SB3.